DOW THEORY LETTERS INC.

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THE MARKET: As I have said many times before, part of the art of technical analysis is knowing when to throw out certain technical indicators and when to accept others. Lately, everyone has been talking about the vast amounts of fund money which are poised to rush into the market. They are talking about the bullishness of odd-lot selling, the strength of the A-D ratio. I am not particularly impressed. Too many services are watching the same indicators.

But one series I follow has made me stop, look and listen. Almost no one follows this indicator. The series is made up of the Dow Industrials, the percentage of all N.Y.S.E. stocks in bullish patterns and the percentage of the 30 Dow stocks in bullish patterns (see chart on page 2).

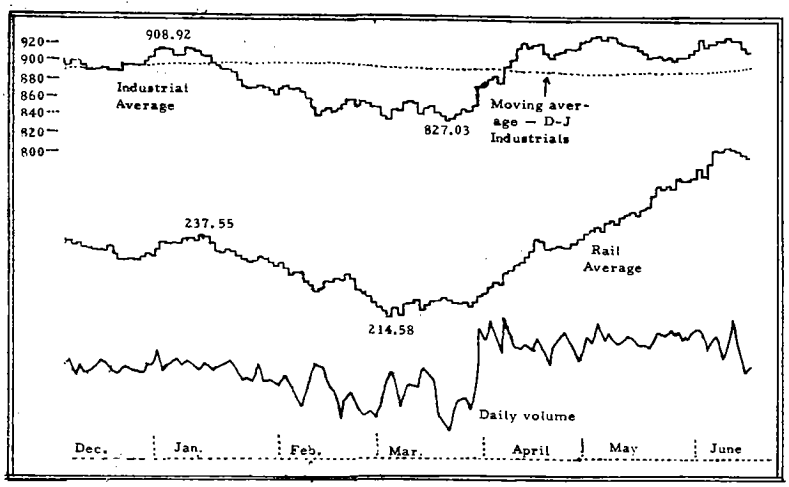
Starting in mid-May, this chart began showing divergence. Note that as of last week the all-stock bullish percentage rose to 76%. But since mid-May the percentage of the 30 Dow stocks bullish has been declining. Two weeks ago the Dow percentage dropped below the critical 50% level. As of the week ending June 14 the Dow indicator sank to 43% bullish.

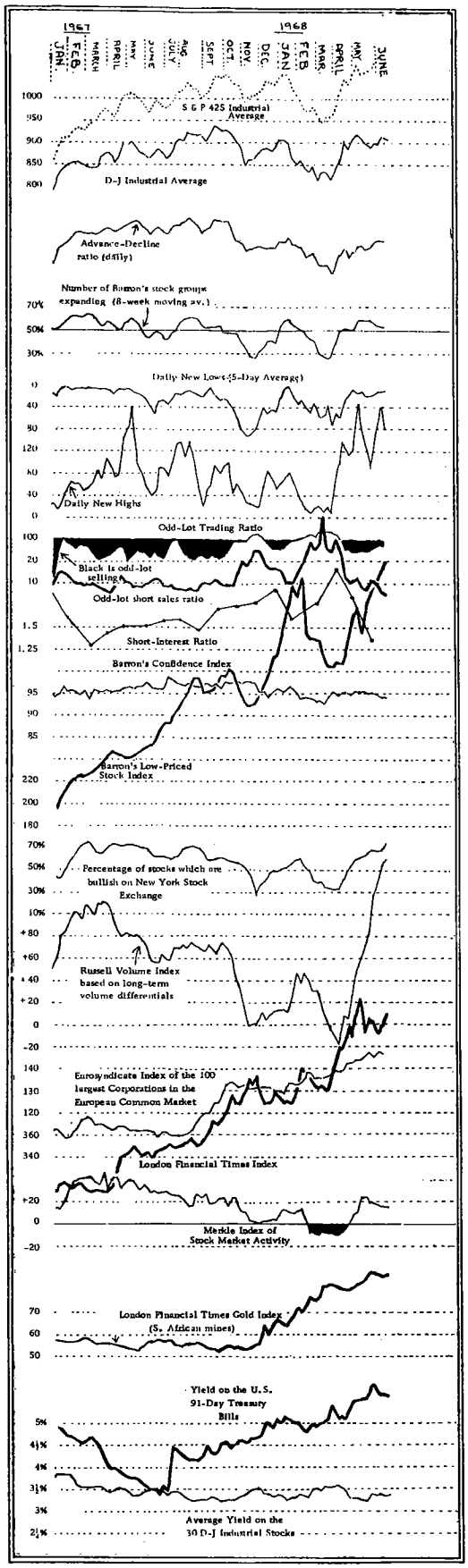
The divergence or pull between the bullish percentage of the investment-grade Dow stocks and the rest of the market is obvious and dramatic. Will the market pull the Dow up or will the Dow drag the market down? I expect the unexpected at this juncture, and the unexpected is for weakness in the Dow to topple the general market. It happened in early 1966 (see last Letter), it happened in 1967, and I believe it could happen now.

From the long-term standpoint (see chart in last Letter), Industrials have still failed to confirm the high recorded by Rails on August 4, 1967. This superior Rail action established an important and continuing non-confirmation under Dow Theory, a non-confirmation which will not be erased unless the Industrial Average can push above its own historic high of 995.15 established in early 1966. With the current weakness in Industrials, such a confirmation does not seem in the cards.

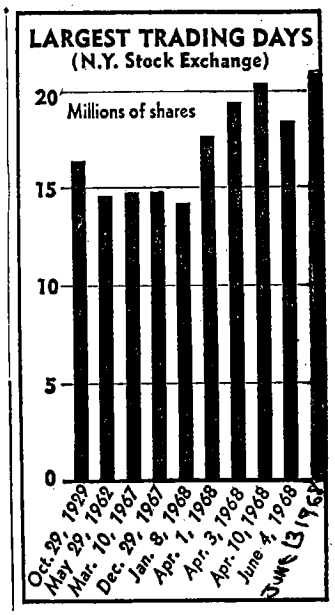
* * * *

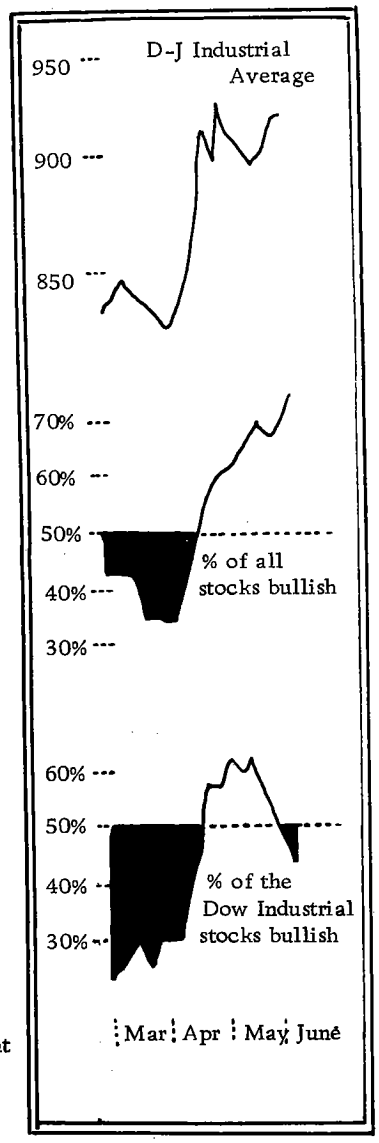
Meanwhile, speculation continues rampant. On the week ending June 7,




1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's stock groups expanding (8-week moving av.)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-lot short sales ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index based on long-term volume differentials
Eurosyndicate Index of the 100 largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Financial Times Gold Index (S. African mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

New York Stock Exchange volume hit 82 million shares, heaviest volume in the history of the Exchange. This little chart (from the New York Times) shows the ten heaviest volume days in N.Y.S.E. history. Significantly, one day appeared in 1929, one in 1962, two in 1967, and no less than six have occurred so far in 1968. Furthermore, five of the six 1968 days were record-breakers, overshadowing even the famous October 29 crash day of 1929.





In the Letter May 1 (Letter 391) I quoted a column from the British Economist regarding the British market, and I stated that everything in the Economist article might soon be applied to our own markets. Last week economist Elliot Janeway dropped me a note, saying that he thought the quote from the May 1 Letter would bear repeating. Here it is:

"But this remains a political market. The investing public is convinced that this (the British) Government cannot control inflation, so that equities are the only safe haven, whatever the short-term economic or commercial prospects. Even a wealth tax would affect only a minority of shareholders.....Whatever economists say, the equity market is a refuge and a way of life. But you might just as well try to predict the future course of prices of paintings as of shares; the two are apparently being bought as touchstones of value more real than money."

In Newsweek (June 17) columnist Clem Morgello writes of American markets, "It's only money—or so investors seem to think. 'The spector of inflation has gripped the public more strongly than in the past,' says Bernard Graham of Hardy & Co. 'Money seems meaningless. There is a flight from the dollar to pieces of paper represented by common stocks.' "

Perhaps a bit of history would prove interesting here. On April 3, 1937 (a few weeks after the bull market of 1932-37 had topped out, but 5 months before the 1937 crash), the great Dow Theorist Robert Rhea wrote, "If fiat money is resorted to, then there will be the usual wild scramble to convert dollars into 'things'. If the tax route is tried, a crisis in Government financing is likely to develop before many months go by. It is difficult to imagine that Mr. Roosevelt or his men in Congress would do anything to curtail expenses, but it would indeed be a pleasant surprise to find that Senator Glass and other honest, patriotic members were sufficiently numerous to out-vote the Administration element."

Sound familiar? Fear of depreciating currency, inflation, higher taxes, a battle in Congress, all the same old saws which have reappeared in 1968. And remember, Rhea wrote the above after the bull market top.

There is no doubt about the troubles of 1968. During the first quarter prices soared at their fastest rate in a decade. The consumer price index rose a full 1.1%, wholesale prices jumped 1.3%. Over the past year workers needed raises of 3.7% just to stay even. Workers received average wage increases of 5.8% during 1968's first quarter. Despite this, a squeeze is on. For instance, the steel companies will probably be forced to give wage increases of around 6% to 10%, even though they are cutting prices as much as 20% on certain items to meet foreign competition.

In an effort to hold back the inflationary hysteria, the Federal Reserve Board increased the borrowed reserves on commerical banks above the minus $500 million mark, for the first time since 1959. Margin requirements for stock purchase have been raised to 80%. Interest rates continue to hold at or near record highs, with all hopes of easing money depending upon the surtax and budget cuts. But many feel that the tax cut (if it passes) is already too late to do much good. Other expenses are coming so fast that budget cuts will merely be surplanted by new programs and additional burdens.

Perhaps indicative of the times, Wall Street's favorite writer these days is Adam Smith (George Goodman—see last Letter). He writes about today's swinging rapacious money managers, whom he terms "yellow eyed wolves," and "gun slingers." The public is referred to as "odd-lot Robert' and "John Jerk." In a recent almost frightening parody, Smith writes of a twelve year old fund manager with a highly successful board of directors whose average age is below 21. They are heavily invested in a new franchise company which sells lemon cookies "with a special ingredient" manufactured in Mexico (the company is already selling at 100 times earnings). In the new Wall Street, says Smith, the object of the game is not to own values but to "get

to the desirable piece of paper ahead of the crowd." Wall Streeters enjoy Smith's writing because there is so much cynical truth in what he writes. His parodies ring so true one must laugh (uneasily) as he reads about the Wall Street circus of 1968.

The circus itself is fascinating but ominous. Perhaps the star performers of the 1968 circus are the food franchising chains. Here the prices have careened so high that they promise to be a sort of "joke-legend" a few years from now. For instance, last month's new offering of Minnie Pearl's Chicken System doubled from $20 to $40 on the day of issue. At the current market value, Minnie Pearl is worth $80 million although its assets are only $2.2 million! By the same score, the new offering of Dunkin' Donuts went to a paper value of $49 million—more than four times assets. Its price/earnings ratio is 61, four times that of General Motors and about that of IBM. This is the way some price/earnings ratios run on leading food franchisers: Denny's Restaurants....59, Henry's Drive In....90, Kentucky Fried Chicken....72, Lum's Inc....73, McDonald's Corp....46.

The total combined market value of Kentucky Fried Chicken and McDonald's Corp. is $668 million. Their combined sales are $102 million. To provide an interesting contrast, Grumman Aircraft with sales of $969 million and profits of $21.5 million has a market value of $239 million. And Grumman has been around a long time.

TAXES: The market action over the past month clearly seems to be discounting the passage of the 10% surtax with the $6 billion budget cut. June 20 is the day which has been set for a Congressional vote on the bill. From a few inside sources, I take it that July 1 is the deadline day for tax passage. If the bill has not been passed by then foreign Central Bankers will likely "throw in the sponge" on the chances of the U.S. acting responsibly on the monetary fronts.

As the Weekly Bond Buyer (June 10) puts it, if the bill has not gone through by July 1 ".....the consequences, in the face of immediate, very heavy Treasury borrowings of $7 to $8 billion through July, August and the first half of September, combined with very bad market expectations, will produce a set of affairs that will shortly lead to an uncontrolled recession at home and violent fluctuations in the foreign exchange markets overseas."

Earlier, Charles Brophy (Bond Buyer Editor) writes, "There are fears that the nation has clearly lost its way, the political leaders and monetary authorities are trying to lead where the citizens apparently will not follow, and all the paraphernalia of monetary failure, fiscal failure, the budget on an uncontrolled binge, the dollar at bay, gold on the loose, the cry for protectionism in order to perpetuate a high cost economy, and the reckless mood of the populace are symptoms of a national malaise which not only seems to be incurable but is becoming progressively worse."

Meanwhile, Indicator Digest reports that in the two months since Congress removed the last gold backing from the dollar, the U.S. money supply has risen to an historic high of $187.7 billion. It soared $5 billion in those two months—at the highest annualized rate in U.S. history. Thus we have living proof of what occurs when dollar-backed currency becomes paper (non-gold backed or fiat) currency. The bulge in the money supply also goes a good deal towards explaining the inflation-panic buying in the U.S. stock markets as well as the fears of dollar-owning foreigners regarding the future of the dollar.

VIETNAM: The "talking and fighting" promised by Hanoi has now become "fighting and talking." To put it another way, North Vietnam is putting the pressure on Saigon itself, and it is threatening to step-up the almost daily rocket attacks. This means that Hanoi is literally daring the U.S. to retaliate—or pressuring the U.S. to start giving in all along the line on negotiations.

If the attacks from Hanoi continue, what will or can the U.S. do? They could call off negotiations and commence bombing of the North again. But this would be a tremendous "moral" defeat, and in the face of an election year would be almost disastrous for the Democratic party. To do this, I would guess that the U.S. would need to double or triple the price of gold (in order to finance a renewed war), and here again the U.S. would face a (monetary) defeat. Aside from accelerating the war, the U.S. could concede victory to Hanoi and attempt to settle at the best, face-saving terms it can muster.

Working with Hanoi, Russia is undoubtedly putting the pressure on Berlin again, as a subtle warning that trouble could start elsewhere unless Vietnam is settled in the Communist interests. In view of the bind which the Communists have now put us in, in view of the precarious state of the dollar, I wonder why anyone would want to be our next President. Give all the candidates credit for being either courageous or ignorant of what is coming up. But then again, maybe they see a silver lining which has somehow escaped me up to this time.

* * * *

These jaded words come from the latest I.F. Stone's Weekly regarding Vietnam: "A high (and hawkish) Pentagon official told a friend of mine recently, 'The purpose of the partial bombing pause and the talks in Paris is to reduce the fighting

to a level the American people will tolerate for a long time without giving up our basic aim, i.e., an independent South Vietnam'."

And this from Max Frankel's Austin dispatch to the New York Times (June 2): "It was primarily to buy time at home to keep waging the war's military and diplomatic battles abroad that Johnson accepted the dovish counsel of at least a partial halt in the bombing on March 31 and threw in his retirement for good measure. So far the tactic has worked better than he dared to hope. The bitter controversy has abated and the political candidates have been muted." In other words, the idea, according to Frankel, was to quiet the peace issue during the political campaign.

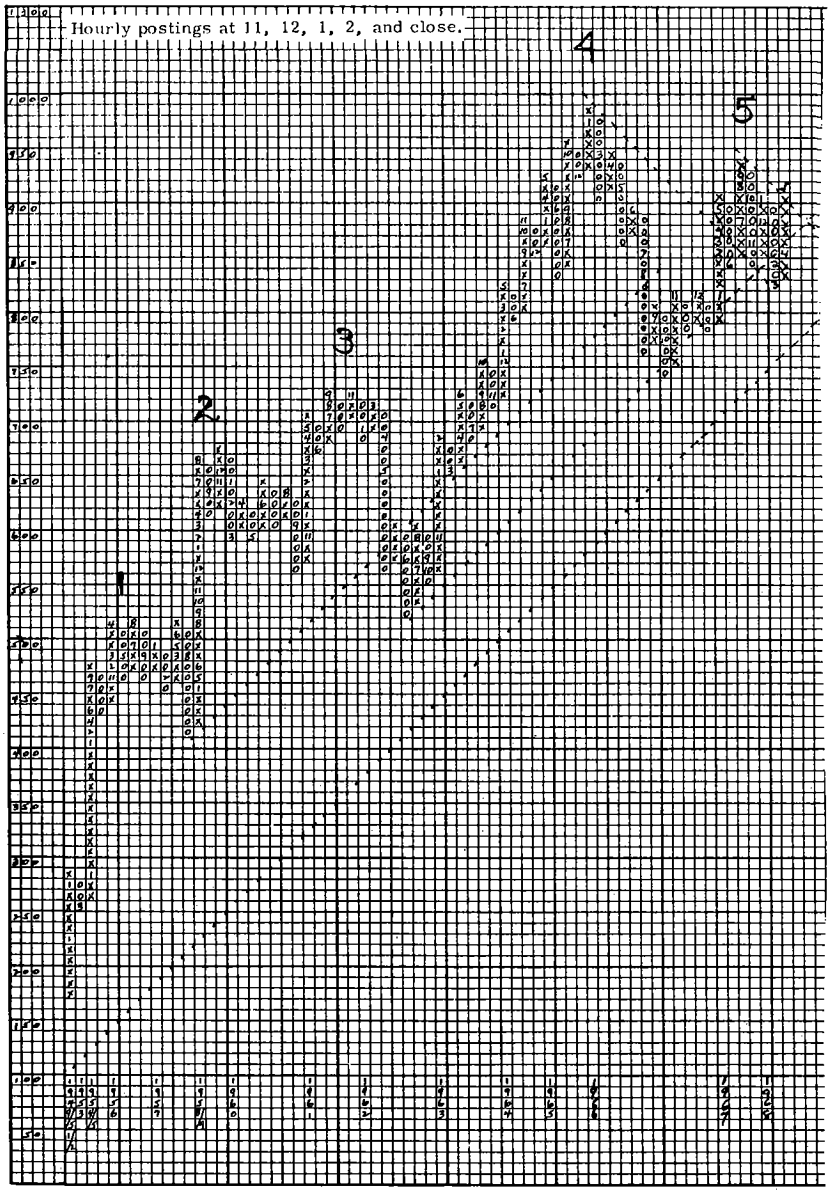
NINETEEN YEARS: The accompanying chart (courtesy of Chartcraft, Larchmont, N.Y.) is a point-and-figure representation of the D-J Industrials covering the period from 1949 to the present. The great value of P & F charting is the quality of concentration. P & F work takes into account movement but not time. Each box on this particular P & F chart represents 10 points on the Dow. A vertical row of X's indicates a rally, a vertical row of O's indicates a decline. Only reversals of 30 points or more are shown on this chart, thereby giving the chart a particularly concentrated quality.

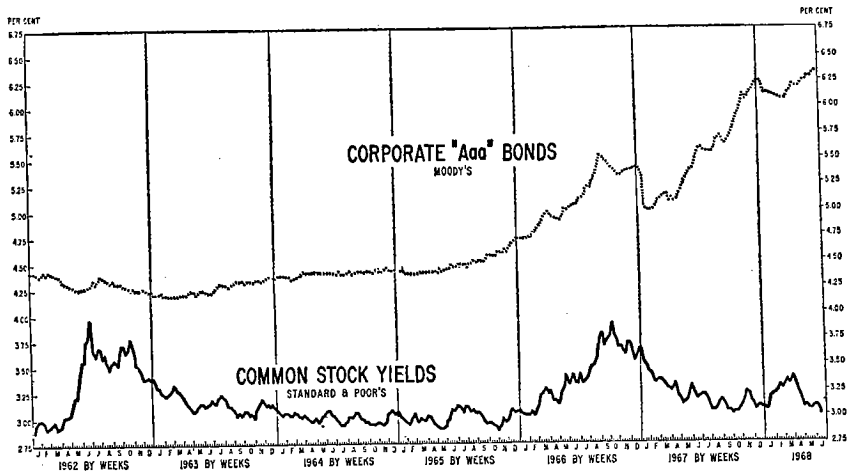
In other words, if the Dow rallies to 800, a row of X's to 800 is shown. If the Dow then fluctuates between 790 and 810 for six months, this does not show on the chart. But if the reversal of the rally to 800 carries back to 760 (a drop of 40 points), a row of O's back to 760 will be drawn. Then if the Dow rises to 820 (an advance of 60 points) a new row of X's to 820 will be shown.

I have marked 5 areas known in P & F as "congestion areas" on the chart. During each of these periods the Dow worked back and forth, creating a solid block of O's and X's on the chart. The areas 1, 2, 3 and 4 may now be studied in retrospect. In retrospect we note that areas 1 through 4 were followed by substantial declines. Therefore, we now know that areas 1 through 4 were zones of distribution.

It is interesting to observe that in true bull market fashion, 2 was formed in the 600-670 area, well above the 440-520 area of zone 1. Area 3 was formed in the 730-690 area,

DOW - JONES INDUSTRIAL AVERAGE (10 x 30 points)





above area 2. Congestion area 4 appeared in the 910-990 area, far above zone 3.

But the current congestion area 5 has been a horse of a different color. Here we see work being done in the 830 to 940 zone. For the first time, a congestion area (in this case 5) is developing below a previous congestion area (4).

I consider this chart picture to be of utmost importance at this time. A clear breakout topside would occur on any Dow closing of 950. Conversely, a bearish signal would be given if the Dow closes below the congestion area at 820. In the meantime, volume continues at record levels, stocks change hands in all markets at a rate never before seen, and veteran market observers wonder whether the next major movement of stocks is to be up above the congestion zone (and perhaps to the old highs) or below the congestion zone for the next leg of the bear market.

WILD YIELD SPREAD: One fundamental statistic which I report upon periodically is the yield spread between stocks and bonds (see chart, page 4). Last week the average yield on the Standard & Poor's comprehensive 500 Stock Average dropped to a low for the year at 3.02%. During the same week the average yield on Moody's Corporate Aaa (top rated) Bond Average rose to a high for the year at 6.30%. This meant that the inverse or negative yield (in favor of bonds) rose to a record 3.28%. This is a phenomenal yield advantage (see chart) for bond buyers, the sort of spread in favor of bonds that may be seen once in two or three generations.

Are bonds a buy here? Certainly, by all historical records they are in the buying zone. As I have said before, no one can pin point the end of a major movement, and I am far from convinced that there will not be one final, crushing "wash-out" in the bond market, a cave-in which will serve to terminate the long bear market in bonds which has been in effect since 1946.

Nevertheless, from a longer-term standpoint, bonds are in a buying zone, and I would not hesitate to place 25% to 33% of assets in top-rated longer term bonds at this time. I would pick bonds which will not be affected by the fluctuations in corporate profits or I would chose U.S. Government bonds, many of which are now selling around 80¢ on the dollar. While such bonds could go lower during a coming final defense of the dollar (via higher interest rates), they should look considerably higher three to five years from now. In other words, I would assume a partial position in longer term bonds at this time with the full realization that none of us possesses the talent to identify the absolute bottom of the bond market.

DOW THEORY MARKET LABORATORY PAGE

Because information on South African gold shares is not readily available (although interest and information is now expanding), I provide periodic brief reviews of leading shares which I have recommended. I would guess that the majority of my subscribers own one or more of the leading S. African gold equities.

Free State Geduld possesses the richest grade of ore of any gold mine, and for this reason there is less leverage here on a potential gold price rise. Earnings over the last four years on Free State have been relatively steady—in the $1.96 to $2.10 per share range. Dividends same as last year at $1.68, but it should be remembered that all S. African gold shares' dividends are subject to a 15% tax. Indicator Digest's new gold report (which is excellent) indicates that if gold goes to $70 per ounce, Free State could earn $4.40 per share.

Blyvoors has a growing interest in uranium and a stable gold business. Profits per shares last year was 67¢ per share with a dividend of 36¢. At $70 gold Blyvoors could earn $1 per share, more as its uranium business gets into full swing.

President Steyn, like Blyvoors, is another low-priced gold share. It is a low-grade mine, which means that there would be big leverage on a gold increase; at $70 gold, Steyn could earn around $1.40 per share. Recently, new rich gold sectors have been discovered on Steyn's property, and there will undoubtedly be a mine developed here. I consider Steyn an attractive purchase. 1967 earnings....33¢, div. 21¢.

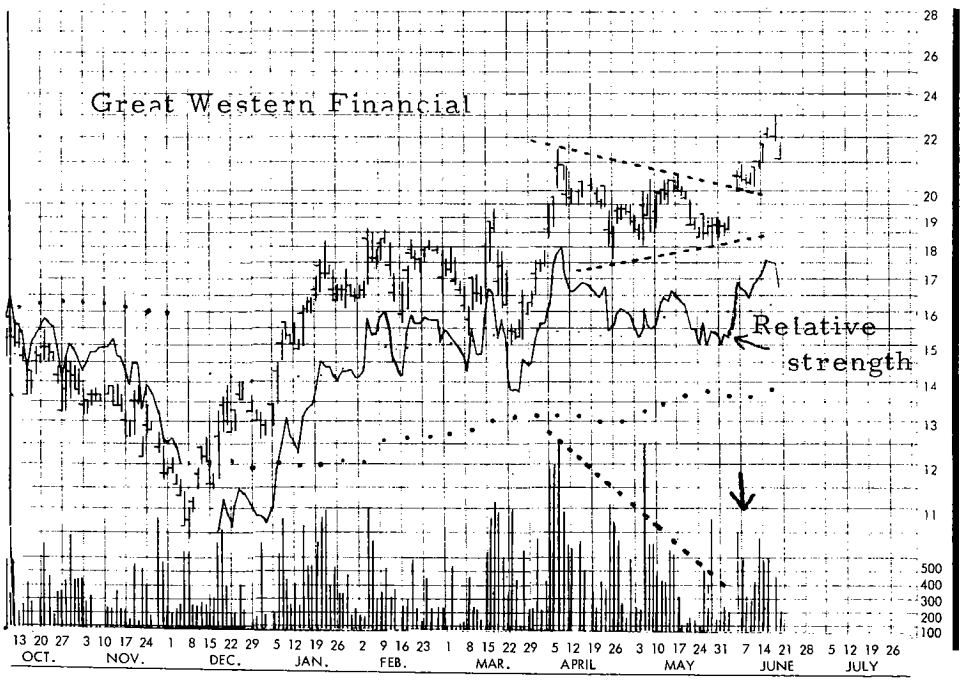
President Brand is a revived situation because of its large interest in the Free State Saaplaas mine which is a huge uranium producer. Dividends at Pres. B. have risen4 years in a row, and earnings last year were $1.13 with a $1.19 dividend. At $70 gold it is estimated that President could earn $3 plus additional uranium earnings.

Western Deep Levels, the world's largest gold enterprise has shown galloping production and profits since opening up in 1962. Profits per share over the past 4 years have run 48¢, 75¢, $1.05, $1.12. Dividends last year were 63¢ per share. Western Deep has a large tax deduction which can be applied against expansion expenses. It has also allocated money for a modest uranium extraction plant. I consider Western Deep a real gold growth stock. At $70 gold, Western Deep would earn about $3 plus any extra uranium profits.

Western Areas is unusual in that it is a new, low-grade ore mine, and therefore has long life, bug reserves and high leverage. Per share profits are now 23¢ with a 7¢ dividend. At $70 gold, Western could earn around $1. The stock sells for about $3 in the over-the-counter ADR market. Ore reserves are estimated to be substantial and could carry 30 to 40 years.

Val Reefs is a stock I have not written up before. It is particularly interesting because it is the largest uranium producer in S. Africa. Uranium tonnage brought out has increases from 1.8 million in 1963 to 2.5 million in 1967. About 1/3 of working profits of Val Reefs comes from uranium, 2/3 from gold. Earnings jumped from 996 in 1966 to $1.71 in 1967. Since its uranium is a by-product of its gold production, Val has probably the cheapest uranium producing set-up in the world. I like this situation very much.

VOLUME: Volume is always to be considered in the movements of individual stocks. While volume indications are never a guarantee of anything, they are always worth studying carefully.



I include a daily chart (courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62003) of Great Western Finance which is a saving & loan holding company. During April and May GWF formed a symmetrical triangle. In order for such formations to be valid volume should, in general, decrease as the pattern progresses. This is what occurred, as seen on the slanting dotted line at the bottom.

During early June GWF jumped or gapped out of the triangle in what appeared to be a powerful move. The stock ran up to 23 before reacting. I have drawn an arrow in the volume section as the point at which GWF rose out of the upper confines of the triangle.

The thing to note here is that the volume implication as GWF moved out of the triangle was unimpressive. In fact, after flaring up momentarily, the volume died down and last week GWF fell back to the 20½ level. This would suggest that the stock did not gather a particularly impressive following as it broke out of its pattern, and because of this I would be only luke warm about the chances of GWF making an important move on the upside from here.

An interesting contrast in volume is seen in the huge flare-up in early April as GWF pushed above the 19½ area. Volume then was double that of early June when GWF again pushed above 20. It would seem that GWF has lost a good bit of its following on the second attempt to move above 20.